Market Maps

Equity Market Drivers Report

January 2021

Tug of war continues – reflation cheer vs lingering pandemic threats

Equity markets have enjoyed a strong start to the new year, as vaccination rollouts and prospects for big hikes in US fiscal spending under a unified Democratic administration fuel hopes for a stronger post-crisis recovery. But with pandemic risks still looming and valuations at historical highs, markets likely face increased volatility near term.

Highlights

Recovery pace hinges on pandemic fight

Upbeat 2021 GDP forecasts come with a long list of caveats; markets signal the return of the reflation trade. (page 2)

Policy support remains steadfast

Back-up in yields poses challenges for central banks vowing to hold to low-rate policies until recovery is entrenched. (page 3)

EPS upgrade cycle plateaus

Vaccine-fueled EPS forecast upcycle paused for some regions and sectors amid second-wave lockdown concerns. (page 4)

Has the US re-rating run its course?

US valuations look stretched by most metrics. But our analysis implies room for further expansion if rates stay low. (page 5)

Russell 2000 sentiment hits new multiyear high

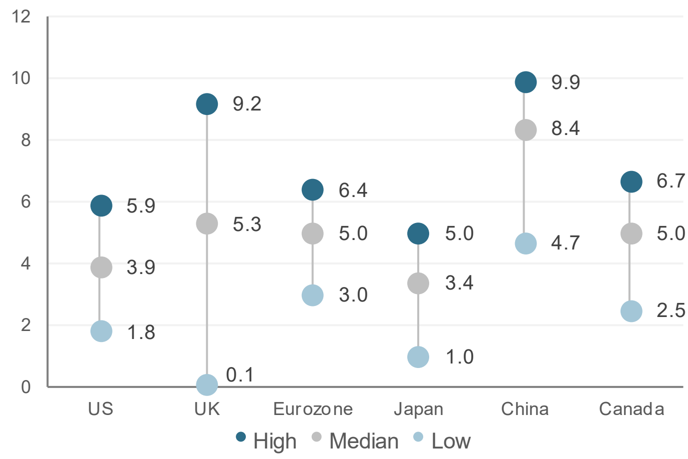
Global sentiment has rebounded strongly after a holiday-season dip; the Russell 2000 reading exceeds the optimistic extremes of last November. (page 6)

Appendix

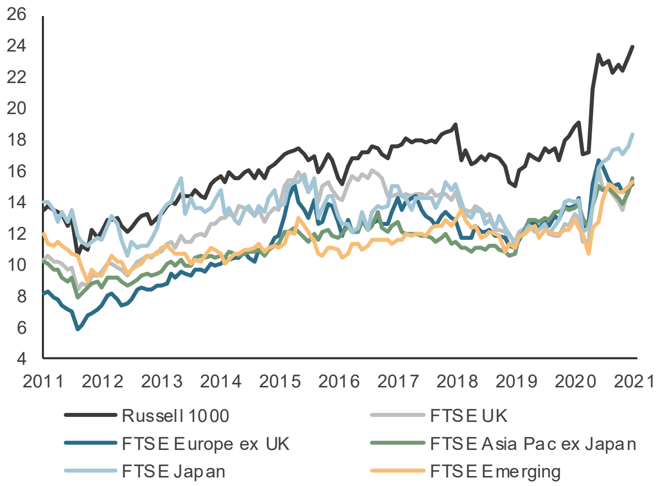
Global Performance, Regional/Sector Valuation, Earnings and Revenue Growth, Estimate Trails and ETF Flows. (pages 7−12)

For professional investors only

The wide range of 2021 GDP forecasts reflects the breadth of uncertainty and possible outcomes in the early stages of recovery.



Forward P/Es sprinted higher in the recent bull run, with the already outsized gap between US and non-US multiples widening further.



CPD MEMBER The CPD Certification Service

1 CE credit

Growth and Inflation Expectations

Growth | Financial | EPS/Rev | Valuation | Sentiment | Composite

GDP forecasts for 2021 are unusually wide-ranging, reflecting the extreme macro crosswinds facing global economies today. Though headline CPI remains depressed, the recent back-up in US Treasury yields confirms a growing focus on reflation as economies revive. Are we on the cusp of a 2011 replay of negative real wage growth?

Chart 1 shows the wide array of consensus 2021 GDP estimates for the world's largest economies, as forecasters weigh the likely drag from renewed lockdowns against the potential growth unleashed once vaccinations bring the virus under control. The breadth of forecasts is particularly pronounced for the UK, which also faces a host of post-Brexit unknowns.

Notably, forecasts for most regions have barely changed in recent months (Chart 2), suggesting that they have yet to factor in the impact of renewed social restrictions in the UK, parts of Europe and the US. If social restrictions persist for an extended period, GDP forecasts are likely to drift lower.

While current headline CPI is low, longer-term inflation expectations have spiked (Chart 3). Notably, US inflation breakevens have climbed above 2%, a level last seen in early 2018 following the passage of the big US tax cut bill. Massive monetary and fiscal stimulus, supply disruption fears and vaccine-spurred growth optimism have all contributed to the pick-up in inflation expectations.

However, while short-term supply shortages could put upward pressure on consumer prices as vaccines revive demand and unlock high household savings later this year, elevated unemployment is likely to restrain wage growth. This combination has raised worries about a potential rerun of the QE-induced period of negative real wage gains in 2011-2012 (Chart 4), which itself could become deflationary. Such a scenario would likely encourage central banks to remain accommodative for some time longer.

Chart 1: The wide array of 2021 GDP forecasts reflects the breadth of possible outcomes in the early stages of the recovery.

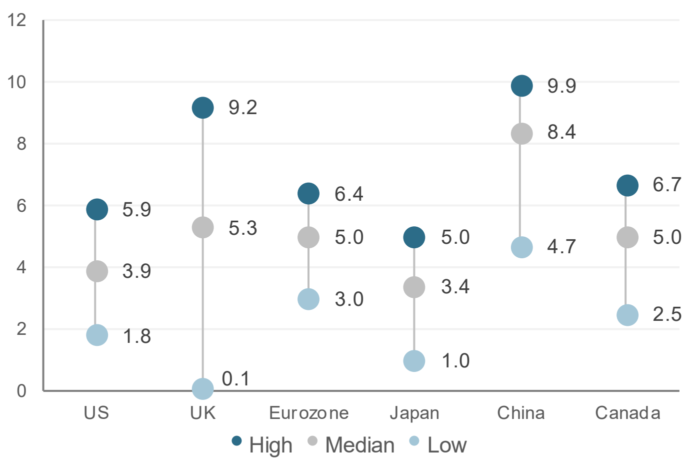


Chart 2: Consensus 2021 GDP forecasts have mostly plateaued and do not seem to factor in fallout from second-wave lockdowns.

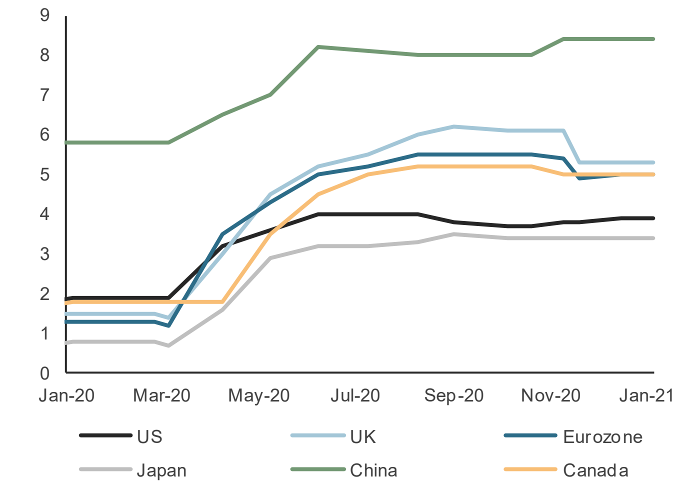


Chart 3: Breakeven inflation has spiked, fueled by vaccination progress and prospects for big hikes in US fiscal spending.

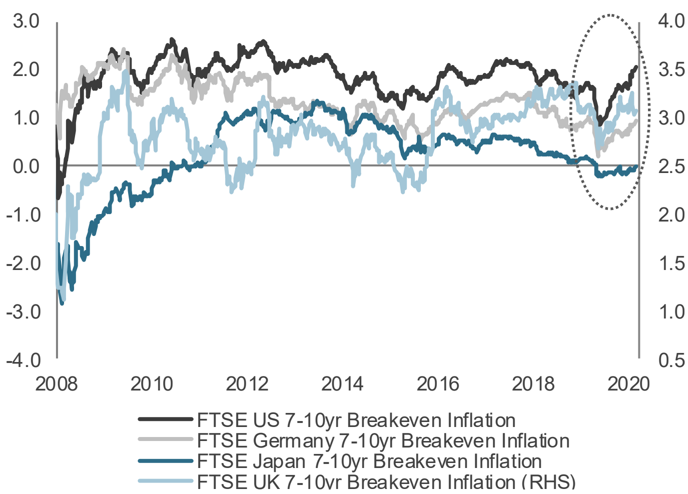
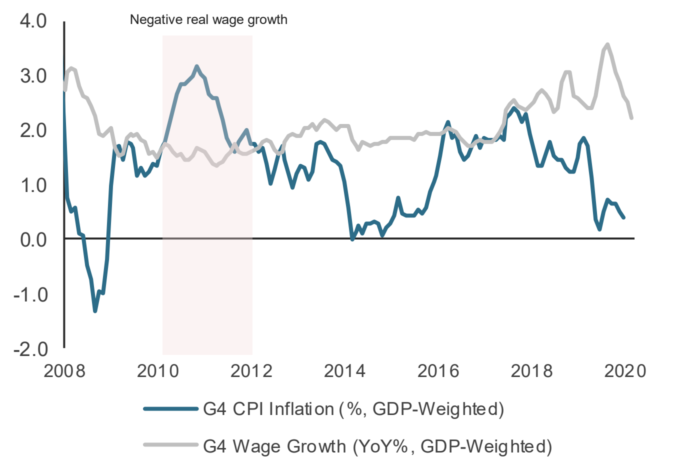


Chart 4: A QE-enabled pickup in inflation poses the potential for a replay of the 2011-2012 period of negative real wage growth.



Source: FTSE Russell and Refinitiv. *Annualized. **Quarterly, year over year. Data as of January 15, 2021. Past performance is no guarantee of future results. Please see the end for important legal disclosures. For professional investors only.